

STATE OF ILLINOIS

I.C.C. DOCKET NO. 04-0779
Cub-CCSAO Exhibit No. 10

ILLINOIS COMMERCE COMMISSION

Date 5/27/05 Reporter TO

Northern Illinois Gas Company)
 d/b/a Nicor Gas Company)
 Proposed General Increase)
 in Natural Gas Rates)

Docket No. 04-0779

**OFFER OF PROOF SUBMITTED BY THE CITIZENS UTILITY BOARD AND
 THE COOK COUNTY STATE'S ATTORNEY'S OFFICE**

STATEMENT OF RICHARD GALLIGAN

CUB/CCSAO retained Mr. Richard Galligan of Exeter Associates to submit testimony regarding the relationship between Nicor Gas and Nicor Services and to address the proper treatment of Nicor Gas/Nicor Services products Gas Line Comfort Guard and HVAC services. Mr. Galligan would have testified that based on facts discerned from data requests and the cross-examination of Nicor Gas witnesses, revenues derived from Nicor Services' sale of these services should be attributed to Nicor Gas for ratemaking purposes.

Nicor Gas's affiliate Nicor Services sells Comfort Guard (CG), an insurance program that protects customers with faulty appliance connectors. Under the program, if a customer has a faulty connector a Nicor Gas technician replaces the connector at no charge to the customer on behalf of Nicor Services. (Nicor Response to CUB DR 3.07). The cost of the program is \$3.95 per month and Nicor Gas has sold the product to 405,585 customers.

Nicor Gas promotes CG through bill inserts, and as set forth below, the vast majority of sales are made by Nicor Gas customer service representatives who receive

inbound calls from Nicor Gas customers with billing questions and other issues unrelated to Comfort Guard. Nicor Gas attributes revenues from the sale of Comfort Guard (\$3.95 per customer per month) to Nicor Services, however the evidence indicates that because of Nicor Gas' level of involvement in the program as described herein, these revenues should be attributed to Nicor Gas.

The CG program is sold as a product to address necessary safety concerns with leaky gas lines, connectors or exposed valves (Nicor Response CUB 3.01, submitted for the record as CUB Ex. 7.0). According to the testimony of Nicor Gas witness D'Alessandro, Nicor Gas used to provide the services provided under its Comfort Guard program. In fact, Nicor Gas technicians continue to provide repair/replacement services for all CG program participants, only the accounting has changed in order to retain unregulated profits under the Nicor Services moniker (Nicor Response to CUB 3.06B Exhibit 3, page 3). This change has resulted in annual profits from the provision of CG of approximately \$14.9 million (see attached Confidential Attachment 1).

Nicor Gas bills contain marketing materials warning customers of the danger of the connectors protected by Comfort Guard as part of a sales effort to sell Comfort Guard (Nicor Response to CUB 3.01 Attachment 1). A Nicor Gas bill insert in July and August 2004 bills specifically warns customers of this danger as part of the sales effort by Nicor Services (Nicor Response to CUB 3.01, submitted for the record as CUB Ex. 7.0).

Nicor Gas is the primary agent responsible for selling CG and HVAC services. Nicor Gas Employees sell CG and HVAC services through Nicor Gas' call center (Nicor Response to CUB 3.05). Nicor Gas customer service representatives, in the call center, sell CG almost exclusively to customers calling in for other reasons. For example, in

May 2003 only 301 out of 173,163 calls to the customer call center were from customers actually calling about Comfort Guard. The rest of the customers called with billing or other questions unrelated to Comfort Guard. (See Nicor Response to CUB 3.13, Exhibit 1.)

According to Nicor Response to CUB 4.03, Nicor Gas customer reps attempted to sell Comfort Guard on at least 19.5% of all calls that they receive. Moreover, according to Nicor Response to CUB 4.05, Nicor completes a sale of either Comfort Guard or HVAC services to 20.4% of the customers it solicits. Nicor Gas' call center solicitations resulted in 124,047 CG sales, out of the 138,203 total CG sales made in 2004. Of the remaining 14,156 sales, only 2,153 were made directly by Nicor Services the rest were primarily customers who moved and kept their CG service. Thus, only 1.56% of CG sales were not made by the Nicor Gas Call center (Nicor Response to CUB 3.06G Exhibit 1).

Nicor Gas clearly emphasizes its reputation and leverages its monopoly status to make these sales. For example, the customer service script is provided as Ex. 3 p.3 in response to CUB DR 3.06 B directs the call center reps to state "With Comfort Guard, a Nicor Gas technician will repair a leak..." Additionally, if the customer indicates they are not interested in CG the script calls for the Nicor Gas representative to emphasize that with CG they have "Access to customer service representatives 24 hours a day, 7 days a week," and that "12 easy payments [are] conveniently added to your gas bill." These conveniences are available because of the fact that Nicor Services is using Nicor Gas' regulated assets in a way that is not available to other non-affiliate companies.

Nicor Gas' service policies and procedures encourage customers to sign up for Comfort Guard. If a customer does not have Comfort Guard and reports a leak, the Nicor Gas technician shuts off the customer's gas and leaves. In this instance the customer must make an additional appointment to fix the leak. However, if the customer is a CG customer the Nicor Gas technician will complete the exposed piping repairs immediately with no additional appointment required (Nicor Response to CUB 3.07). Nicor Gas also favors Nicor Services customers by providing annual inspections under the CG program for only \$58 instead of its standard \$68 charge applicable to its non-CG customers (Nicor Response to CUB 3.06B Exhibit 3, page 3).

The transactions between Nicor Gas and Nicor Services regarding Comfort Guard were not arms length transactions. These transactions were not consistent with the Operating Agreement, which sets forth the rules for transactions between Nicor Gas and its affiliates (Nicor Response to CUB 3.09 Exhibit 1). Moreover, the fact that the Operating Agreement set forth principles for such transactions does not preclude review of the revenues from those transactions during the course of a rate case.

There is precedent to attribute affiliate revenues to the utility when a close relationship between the utility and its affiliate are evident in the provision of the affiliate programs. For example, in the Baltimore Gas and Electric rate case before the Maryland Public Service Commission, Case No. 8829, Order No. 76260, wherein that Commission recognized 50 percent of a BGE affiliate's profits because of the "strong connection" found between BGE and its affiliate. In that case, the strong connection rested entirely on the affiliate's use of BGE for billing services provided to the affiliate, and upon the utility's general telephone number leading callers to an affiliate option. In the BGE case,

as here, the utility argued that its cost allocation procedures operated so as to obviate any need to recognize any affiliate profits.

The relationship between Nicor Gas and Nicor Services here is greater than the “strong connection” finding in the BGE case. The BGE case stands for the proposition that when a strong connection exists between a utility and its affiliate in the provision of non-regulated services, the mere allocation of fully distributed costs does not fully and properly compensate the utility for the value of its services provided to the affiliate. The extensive relationship between Nicor Gas and Nicor Service regarding the provision of the CG program supports a finding that CG revenues should be considered regulated utility revenues.

The Operating Agreement sets forth methods to determine the charges to be assessed when assets, or the use of assets or services, are provided by Nicor Gas to its affiliates. Included in the required methods are charges based on the fair market value of the assets or intangible assets, or the prevailing price, or prices equal to or higher than fully distributed cost. Section 5.1 of Article V of the operating agreement (provided as Exhibit 1 in Nicor Response to CUB 3.09) requires the use of fully distributed costs, if fair market value or prevailing prices are neither known nor practicably determinable.

Nicor Gas knowingly violated the Operating Agreement by failing to even attempt to determine fair market value in charging Nicor Services for the assets used, and in so doing Nicor Gas significantly, substantially, and unreasonably reduced the flow of revenues it was entitled to receive from Nicor Services.

The fair market value of the resources that Nicor Gas made available to the CG program could have been determined, as required by the “...if practicably determinable”

standard. Through the CG program and the existing business relationship between Nicor Services and Nicor Gas, Nicor Services receives approximately \$14.9 million in profit (see Confidential Attachment 1). In the presence of competitive forces the resources that Nicor Gas has made available to Nicor Services would result in Nicor Gas being the recipient of virtually all of this revenue. No rational firm operating in a competitive market would provide the afore mentioned assets to another firm at only it's fully distributed costs. Based on this finding, the CG revenues must be recognized as Nicor Gas revenues, consistent with the competitive standard of utility regulation. Under the competitive standard, utilities are regulated by the Commission so as to emulate the results that would have obtained, if the utility had operated in a competitive market.

CONCLUSION

Until 1999 Nicor Gas performed the repair/replacement services now covered by CG as a utility service and associated revenues were included in Nicor Gas' utility revenues. This was appropriate. The services provided by Nicor Gas to its affiliate, Nicor Services, under the CG program are monopoly services that no other competitor possibly could provide in competition with Nicor. Based on these facts, it is clear that the Nicor Gas provides all elements of CG program. Thus, the revenues associated with this Nicor Gas-provided CG service program should be recognized as Nicor Gas test year revenues.